

DEVELOPMENTS IN THE LONDON LISTING MARKETS: FINANCIAL SERVICES AND MARKETS ACT 2023 AND CHANGES TO UK FINANCIAL PROMOTION REGIME

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As the UK adapts to its new position outside the EU, the government is working to stimulate growth and bolster its global competitiveness and attractiveness as a financial hub. This update covers two avenues through which the UK government is seeking to do so.

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The first is the passing into law of the Financial Services and Markets Act 2023 ("FSMA 2023") last summer, with a view to creating a smarter financial services regulatory framework for the UK that is flexible, less costly and more responsive to emerging trends. The second is the review of the regulation of financial promotions, in particular reforms to the exemptions for high net worth individuals and sophisticated investors. Following consultation, changes to these exemptions came into effect on 31 January 2024 but some of these were subsequently reversed from 27 March 2024.

Our 2024 series of updates in relation to developments in the London listing markets can be found [here](#).

FINANCIAL SERVICES AND MARKETS ACT 2023

On 29 June 2023, the FMSA 2023, which creates a new financial services regulatory framework for the UK and provides for repeal and reform of certain financial services legislation that it had inherited through its EU membership, received royal assent. It implements the proposals set out in the Future Regulatory Framework Review, established by the government in the wake of Brexit, with the aim of designing a Smarter Regulatory Framework ("SRF") for the future based on the existing domestic model principally set out in the Financial Services and Markets Act 2000 ("FSMA model"). Under the FSMA model, the FSMA 2023 creates the statutory framework but bestows the responsibility of setting detailed rules on the relevant regulators; namely, the Financial Conduct Authority ("FCA") and the Prudential Regulation Authority ("PRA"). Our update from 1 February 2023, which outlined the key aspects of FSMA 2023 when it was at bill stage, can be found [here](#).

As part of the Edinburgh Reforms (the financial services reforms announced by the Chancellor in November 2022), the government published a policy statement outlining its approach to delivering the SRF under FSMA 2023. On 11 July 2023, it published a plan for delivery describing how it will deliver its approach in practice. This states that each piece of retained EU law related to financial services is now within a “transitional period,” which will last until it is specifically repealed. This will occur in a phased and sequenced manner to ensure industry is able to plan ahead, and only when any replacement regime is finalised. Retained EU law will be replaced with a mixture of legislation introduced by government and approved by parliament and regulator rules in line with the balance of responsibilities in the FSMA model. This means industry stakeholders should largely expect firm-facing provisions to be defined through regulator rulebooks, reflecting the SRF’s objective to deliver a more agile, streamlined, accessible and coherent regime.

Certain regulations have already been made, bringing into force key provisions of the FSMA 2023 and commencing the repeal of certain secondary legislation considered unnecessary by the government.

Commentary

"Retained EU law will be replaced with a mixture of legislation introduced by government and approved by parliament and regulator rules."

Delivering the SRF will entail significant structural reform of how the UK financial services sector is currently regulated. However, it remains to be seen exactly how far-reaching these changes will be and how long they will take, given the phased approach. Much like the reconstruction of a building and its foundations, the FSMA 2023 represents a replacement of a building’s foundations; a stronger framework on which the government and regulators alike can build. But the extent to which walls will be demolished, new ones rebuilt and entire rooms refurbished, is unknown.

CHANGES TO FINANCIAL PROMOTION EXEMPTIONS

Following a consultation by HM Treasury in December 2021, a response document published in November 2023 and secondary legislation published in December 2023, changes to the exemptions for high net worth individuals and sophisticated investors under the UK financial promotion regime came into force on 31 January 2024. The purpose was to update them to reflect economic, social and technological changes that have occurred since their original introduction (which had made thresholds easier to satisfy) and avoid their misuse. Subsequently, regulations were published in early March 2024 reversing some of these changes, without consultation, with effect from 27 March 2024. The reason given was that significant stakeholder concerns had been raised about the potential unintended impacts of the January 2024 changes to the exemptions. Specifically, the technology, angel investing and theatre sectors raised concerns that these could affect the ability of start-up businesses to obtain investment, and the ability to finance theatre productions through small-sale investors.

UK financial promotion regime

A financial promotion is a communication that contains an invitation or inducement to engage in a financial product or service. In the UK, the communication of financial promotions is subject to regulatory safeguards which seek to ensure consumers are suitably protected so that they can make informed and appropriate decisions.

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In general, an individual or business cannot communicate a financial promotion unless (i) the content of the promotion is approved by a firm which is authorised by the FCA or PRA; or (ii) the individual or business is authorised itself; or (iii) an exemption to the regime applies. Breach of these is a criminal offence.

A number of exemptions exist which enable unauthorised persons to communicate financial promotions in certain circumstances, including to defined groups or individual investors. The original exemptions for certified high net worth individuals, sophisticated investors and self-certified sophisticated investors were introduced to help small and medium sized enterprises ("SMEs") raise finance from sophisticated

private investors, or "business angels", without the cost of having to comply with the financial promotion regime and seek the approval of an authorised firm.

Government review of exemptions

The 2021 consultation on the high net worth individual and sophisticated investor exemptions was prompted by the fact that they had not been substantively updated since 2005 to reflect the economic, social and technological changes that have occurred since they were originally introduced (and which have made thresholds easier to satisfy). There was also concern about misuse of the exemptions, to market products to investors who are not high net worth or sophisticated.

Although the review considered all three exemptions for certified high net worth individuals, sophisticated investors and self-certified sophisticated investors, the actual changes made only relate to the exemptions for certified high net worth individuals and self-certified sophisticated investors. These two exemptions can only be used to market investments in unlisted companies (and not listed shares or those traded on AIM or the AQSE Growth Market).

Key changes made in January 2024

The key changes were:

- *increased thresholds for high net worth individuals* – the financial thresholds to be eligible for the high net worth individual exemption were raised in line with inflation to £170,000 of income in the previous financial year (up from £100,000) or to have held net assets of £430,000 throughout the previous financial year (up from £250,000); there was no change to the assets in scope of the net asset calculation (which, for example, exclude an investor's primary residence and pension benefits);
- *amended criteria for self-certified sophisticated investors* – the criteria have been amended to:
 - remove the criterion that an investor has made more than one investment in an unlisted company in the previous two years, as the rise in online investing means that this was no longer considered a reliable way to demonstrate sophistication; and

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- increase the financial threshold in the “company director” criterion to £1.6m from £1m (so that directors of companies with at least £1.6m annual turnover in the last two years would be eligible for the self-certified sophisticated investor exemption) – the government considered that this was a sufficiently high bar to demonstrate business success and sophistication and would exclude less experienced directors;
- *updated title of the high net worth individual exemption to remove the reference to “certified”* – to make it clear that third-party certification is not required for this exemption;
- *requirement for businesses to provide details in communications* – businesses are required to provide details about themselves in any communications made using the exemptions, e.g. company address, contact information and the company’s registration details (i.e. Companies House number or international equivalent). The purpose is to help prospective investors undertake due diligence on businesses that are marketing investments;
- *updated investor statements* – changes were made to the statements that investors are required to complete and sign in order to be classified as high net worth individuals or self-certified sophisticated investors to update their format, simplify the language and require greater investor engagement. These aim to ensure investors correctly certify themselves and it remains their responsibility to do so. In particular:
 - the sections of the statements were reordered so that the conditions to be considered a high net worth or sophisticated investor appear at the top of the statements. It is also made clearer that regulatory protections will be lost by receiving financial promotions under the exemptions;
 - the language was simplified by removing references to certain financial services legislation and including a more consumer-friendly explanation of which assets are not in scope of the net asset calculation; and
 - investors must select the specific criteria that they meet in order to be classified as high net worth or sophisticated and must set out how they meet the relevant criterion e.g. in the case of the high net worth individual exemption, an investor must declare their income and/or the value of their net assets to the nearest £10,000/£100,000 respectively.

The changes made to the financial promotion regime were also applied to the equivalent exemptions under the regime restricting promotion of collective investment schemes.

Proposals not taken forward

The government had proposed placing a degree of responsibility on firms to ensure individuals actually meet the criteria to be deemed high net worth or sophisticated, rather than just believing on reasonable grounds that the relevant investor statements have been signed. Due to opposition to this proposal, this was dropped from the changes introduced on 31 January 2024.

March 2024 changes

"From 27 March 2024, the criteria to be eligible for the high net worth and self-certified sophisticated investor exemptions are amended to reinstate the thresholds and criteria that previously applied."

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From 27 March 2024, the criteria to be eligible for the high net worth and self-certified sophisticated investor exemptions are amended to reinstate the thresholds and criteria that previously applied, whilst retaining the updated format of the investor statements introduced in January 2024. Accordingly, in summary:

- for the high net worth individual exemption, the income and net assets thresholds are reduced to £100,000 and £250,000 respectively; and
- for the self-certified sophisticated investor exemption, the criterion of having made two or more investments in an unlisted company in the previous two years is reinstated and the “company director” criterion is amended by reducing the company turnover required back to £1m.

"Any investor statement that has been completed and signed that complies with the January 2024 changes will remain valid until and including 30 January 2025."

The changes have been made through updating the investor statements that potential investors are required to complete and sign in order to be classified as high net worth or sophisticated. The equivalent exemptions under the regime restricting promotion of collective investment schemes have been updated in the same way.

HM Treasury has said it will carry out further work to review the scope of the exemptions.

Transitional period for investor statements

Any investor statement that has been completed and signed that complies with the January 2024 changes will remain valid until and including 30 January 2025, as an alternative to the form of statement introduced in March 2024. From 31 January 2025, potential investors must have completed and signed a statement in the March 2024 form.

Other related initiatives

The review of these exemptions forms part of a wider initiative by the government and the FCA to review the regulation of financial promotions. The government is introducing new measures to improve the quality of financial promotions made by unauthorised firms and approved by authorised firms, through the introduction of a financial promotions gateway. This regulatory gateway was legislated for in the FSMA 2023 and will require any authorised firm wishing to approve financial promotions of an unauthorised firm to first obtain permission from the FCA, unless an exemption applies. The new regulatory gateway came into force on 7 February 2024.

Commentary

It is clear that the high net worth individual and sophisticated investor exemptions continue to have an important role to play in enabling angel investment in the economy and SME capital raising. However, the January 2024 changes and the subsequent about turn by the government reflect the delicate balancing act required between updating the exemptions and ensuring these adequately protect consumers while preserving the ability of unlisted companies and businesses, whether at an early stage of development or as part of pre-IPO fundraisings, to raise finance under the exemptions. In making the latest changes, the government has bowed to the concerns expressed by relevant stakeholders while leaving it open to consider further changes.

CONCLUSION

Although limited in scope, as it turns out, the reforms to the financial promotion regime are welcome in so far as they simplify and clarify the form of investor statements used. We will have to see if any further changes take place. In terms of wider financial services reform, there is a long way to go but we will be following the progress of these reforms over the coming months and will report on relevant changes, their timing and the practical implications for our clients and contacts.

Of particular interest is the responsibility placed on the FCA to enact the government's proposals for the reform of the rules relating to prospectuses and making public offers, which aim to make fundraisings and listing on London's various markets simpler and a more attractive option for UK and overseas companies. We included an update on how these proposals are progressing in an earlier article in this series.

London Trainee Laura Izquierdo also contributed to this article.

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